**ILLINOIS POWER COMPANY**

**ILLINOIS COMMERCE COMMISSION**

**DOCKET NO. 01-0432**

**EXHIBITS SPONSORED BY PEGGY E. CARTER**

**OCTOBER 10, 2001**

TABLE OF CONTENTS

# ILLINOIS COMMERCE COMMISSION

## DOCKET NO. 01-0432

## PREPARED REBUTTAL TESTIMONY OF PEGGY E. CARTER

## OCTOBER 10, 2001

## I. Introduction and Witness Qualifications

1. Q. Please state your name, business address and present position.

A. Peggy E. Carter, 500 South 27th Street, Decatur, Illinois 62521. I am Vice President and Controller of Illinois Power Company ("Illinois Power", "IP" or the "Company").

2. Q. Have you previously submitted testimony and exhibits in this proceeding?

A. Yes, I have submitted direct and supplemental testimony in this proceeding. My direct testimony and exhibits were identified as IP Exhibits 1.1 through 1.30. My supplemental testimony has been marked as IP Exhibit 1.31 and was accompanied by IP Exhibits 1.32 and 1.33 and Corrected Revised IP Exhibits 1.2, 1.3, 1.5, 1.7, 1.9, 1.10, 1.11, 1.22, 1.23, 1.26 and 1.28.

## II. Purpose and Scope

3. Q. What is the purpose of your rebuttal testimony?

A. I will respond to issues raised by Illinois Commerce Commission ("ICC" or the "Commission") Staff witnesses Hathhorn, Everson, Pearce, and Lazare. I will also address certain issues raised by Illinois Industrial Energy Consumers ("IIEC") witness Phillips and Citizens Utility Board/Attorney General ("CUB/AG") witness Effron.

4. Q. In addition to your rebuttal testimony in IP Exhibit 1.34, which consists of questions and answers 1 through 166 inclusive, are you sponsoring any other exhibits?

A. Yes, I am sponsoring IP Exhibits 1.35 through 1.62, which were prepared under my supervision and direction.

## III. Rate Base

5. Q. What issues will you address in your rebuttal testimony related to rate base?

A. I will respond to the following issues:

A. Functionalization of General and Intangible ("G&I") plant;

B. Inclusion of known and measurable capital additions for G&I plant through June 30, 2002;

C. Accumulated depreciation and accumulated deferred income taxes associated with embedded plant in service through June 30, 2001;

D. The appropriate lead/lag associated with two items within the Company's cash working capital analysis;

E. Capitalization of severance costs;

F. Exclusion of certain deferred income taxes from rate base; and

G. Accumulated depreciation and accumulated deferred income taxes related to plant additions.

6. Q. Are any of your previously filed exhibits pertaining to rate base superseded by exhibits you are submitting with this rebuttal testimony?

A. Yes, the following exhibits reflect changes to my previously filed exhibits:

* Exhibit 1.35 (supersedes Corrected Revised IP Exhibit 1.5) presents the summary of corporate G&I plant additions. IP Exhibit 1.35 incorporates actual loading rates on corporate G&I plant expenditures through August 2001;
* Exhibit 1.36 (supersedes Corrected Revised IP Exhibit 1.9) presents the increase in Accumulated Depreciation associated with the pro forma plant additions presented by Mr. Barud and me in rebuttal;
* Exhibit 1.37 (supersedes Corrected Revised IP Exhibit 1.10) presents the updated calculation of cash working capital incorporating the effect of various revisions since the Company's original filing; and
* Exhibit 1.38 (supersedes Corrected Revised IP Exhibit 1.11) presents the increase to Accumulated Deferred Income Taxes associated with the pro forma plant additions presented by Mr. Barud and me in rebuttal.

## A. Functionalization of General and Intangible Plant

7. Q. Have parties to this proceeding taken exception to the level of G&I plant included in IP's electric distribution rate base?

A. Yes, ICC Staff witness Lazare and IIEC witness Phillips have proposed adjustments to IP's proposed G&I plant component of rate base.

8. Q. What is Staff witness Lazare's proposed adjustment to the functionalization of G&I plant?

A. Staff witness Lazare proposes that "the increase for General and Intangible Plant should be commensurate with the increase in other distribution accounts." (ICC Staff Exhibit 5.0, p.16, lines 339-342). Mr. Lazare's proposal disallows the amount of G&I plant included in IP's rate

base above this level, which he calculates to be a 20.91 percent increase in distribution plant balances from the amount allowed by the Commission in Docket Nos. 99-0120/99-0134 (Cons.) ("1999 DST case") to the level of distribution plant requested by IP in this proceeding.

9. Q. What do you understand to be Mr. Lazare's principal concerns regarding the level of G&I plant that IP has assigned to the electric distribution business?

A. I understand the following three factors to be Mr. Lazare's principal concerns relating to the level of G&I plant that IP has included in the electric distribution business rate base:

* Electric ratepayers would be adversely affected by IP's divestiture of generation if the Company's proposed allocation is adopted;
* The Company has not explained the increases in G&I plant over the levels allowed in IP's 1999 DST case; and
* Commission precedent for allocating G&I plant should be preserved.

Mr. Lazare has similar concerns with respect to the level of Administrative and General ("A&G") expenses that IP has included in its electric distribution revenue requirement.

10. Q. Please describe the types of assets that are classified as G&I plant.

A. General plant consists of assets such as office buildings, furniture, computers, vehicles, and other equipment. Intangible plant includes assets such as software programs. Both general and intangible plant may be used in support of one or more lines of business.

11. Q. Do you agree with Mr. Lazare's characterization that IP has failed to remove "generation-related" costs from its distribution revenue requirement and has "shifted costs" to the "regulated utility"?

A. No. As I will show in this testimony, those G&I assets that directly supported IP's fossil and nuclear generating stations were included in the transfer/sale of the generating facilities. To the extent IP continued to provide services or facilities to the new owners of the generating stations in 2000, IP charged the owners for those services and facilities. However, Mr. Lazare's fundamental error is in believing that a portion of IP's remaining G&I plant and A&G expenses are "generation-related". IP's G&I plant and A&G expenses are common costs that support all lines of business in which IP is engaged (i.e., gas, electric transmission and electric distribution). It is the nature of joint and common costs that they are needed to support a single line of business, but can also support additional lines of business without any significant increase. Correspondingly, the elimination of one of several lines of business does not necessarily mean that common costs can be reduced significantly. The labor allocator is one method used to assign such common costs among all of the utility's lines of business for regulatory costing and rate-setting purposes. However, the fact that a portion of IP's common costs in 1997 were allocated to the generation function by use of the labor allocator, in order to set electric delivery services rates, does not make these costs "generation-related." The G&I plant and A&G expenses recorded on IP's books in 2000, after IP sold its generation assets and exited the generation business, remain common costs which support all of IP's lines of business. Consistent with the Commission's requirement in the 1999 DST case, IP has used the labor allocator to allocate these common costs among the businesses in which IP was engaged in 2000. IP has not "shifted costs" to the regulated utility; the G&I plant and A&G expenses of the Company were always costs of the regulated utility.

12. Q. Can G&I plant be directly assigned to a particular line of business?

A. Yes, as Mr. Lazare states at line 250 of his direct testimony, "the key to determining cost allocations is how costs are caused." The same is true with the allocation of G&I plant. The Company presented a detailed asset separation study in the 1999 DST case which identified how each individual asset was actually being used and assigned or allocated the cost of the assets based upon the use of the asset.

13. Q. Did the Commission accept the results of the Company's asset separation study?

A. No, the Commission opted to employ a generic labor allocator to allocate both G&I plant and A&G expenses in proportion to the direct salaries and wages charged to the individual lines of business.

14. Q. What method did the Company employ to allocate its G&I plant in this proceeding?

A. For ratemaking purposes in this proceeding, the Company adopted the labor allocator to assign G&I plant among the lines of business within IP.

15. Q. Does the Company believe this is the most appropriate method to allocate G&I plant?

A. No, the Company continues to believe that an asset separation study, similar to the one IP submitted in support of the functionalization of G&I plant in its last DST proceeding, is superior to the use of a general allocator. A labor allocator can be used as a surrogate for cost causation or actual utilization of assets; however, specific data related to the actual usage of an asset will provide more accurate results for assigning costs.

16. Q. Has Mr. Lazare expressed any concerns as to how IP calculated the labor allocators and applied those allocators to G&I plant?

A. No. Mr. Lazare has not presented any concerns pertaining to how the Company calculated the labor allocators and applied such allocators to G&I plant. Mr. Lazare has not asserted that IP calculated or applied the labor allocators incorrectly, nor has he applied them in a different manner to IP's G&I plant (and A&G expenses) to arrive at a different result. In fact, his recommendation completely ignores the labor allocator. Instead, Mr. Lazare has focused solely on the results produced by the use of the labor allocation methodology in this case.

17. Q. Has IP presented evidence on the reasonableness of its additions to G&I plant?

A. Yes. In the 1999 DST case, IP presented evidence to describe and justify significant G&I plant additions that had been made or were planned subsequent to 1992, when an electric rate base was last established for the Company, through 2000. The test year in the 1999 DST case was 1997. Similarly, in this case, the Company has presented evidence describing and justifying its significant additions to G&I plant in 1998 through 2000 and its significant planned additions to G&I plant from January 1, 2001 through June 30, 2002.

18. Q. Have the structure and nature of the services IP provides changed since the last DST proceeding?

A. Yes. As I noted in my last answer, the test year in the 1999 DST case was the 12 months ended December 31, 1997. At that time, IP was a vertically integrated utility. The Company owned a nuclear generating station, as well as a number of fossil generating plants. Since that time, IP has sold the nuclear facility to AmerGen Energy Company ("AmerGen"), an unaffiliated company. The Company has also transferred ownership of its fossil generating facilities to its parent company, Illinova Corporation, which transferred ownership to another affiliated

company, Illinova Power Marketing, Inc. ("IPMI"). These transfers occurred in 1999. (Subsequent to the transfer of the fossil generating facilities to IPMI, Illinova merged with Dynegy, Inc. ("Dynegy") in February 2000. IPMI was renamed Dynegy Midwest Generation, Inc. ("DMG") and became a wholly-owned subsidiary of Dynegy.) As a result, since prior to the start of the 2000 test year, IP has consisted only of the gas, electric transmission and electric distribution businesses. Except for a small ownership interest in a non-utility generator facility at a customer's site, which is equal to .06 percent of electric plant in service, IP owned no generation during the 2000 test year. Similarly, IP recorded only $3,700 of production labor and a total of $11,546 of production O&M expense (i.e., 0.0013% of total electric O&M) in 2000. Thus, IP essentially owned no generation and had no generation labor in 2000. As a result, the allocators developed for this filing do not functionalize any G&I plant to generation.

19. Q. Mr. Lazare asserts that IP's allocation of G&I plant in this case is inconsistent with Ameren's allocation of G&I plant in its current DST case, Docket No. 00-0802. Do you agree?

A. No. It is my understanding that for purposes of its DST filing in Docket No. 00-0802, the Ameren utilities (Union Electric Company ("UE") and Central Illinois Public Service Company ("CIPS")), used a calendar year 1999 test year. I further understand that during 1999, both UE and CIPS still owned and operated generation facilities. Under those circumstances, in allocating common costs and assets to each line of business that those common costs or assets support, it was appropriate for UE and CIPS to allocate a portion of G&I plant to the generation business. The facts are different in this case because IP had exited the generation business prior to the test year, and during the test year owned essentially no generation and had

no generation-related labor.

20. Q. Mr. Lazare cites a number of excerpts from IP witness Alec Dreyer's testimony in Docket No. 99-0209. Please explain the nature and timing of that proceeding.

A. Docket No. 99-0209 was a filing made by IP notifying the Commission of its intent to transfer its fossil generating facilities to Illinova, which in turn would transfer these assets into a newly formed affiliate. The filing was made on April 16, 1999. The Commission issued its order approving the transfer of the fossil generating assets on July 8, 1999.

21. Q. Mr. Lazare quotes an excerpt from the testimony of Company witness Dreyer in Docket 99-0209. What were the complete question to and answer from Mr. Dreyer from which this excerpt is taken?

A. The complete question and answer were as follows:

> Q. Will Illinois Power's retail electric customers observe any difference in their electric service after the proposed transfer?
>
> A. No, *Illinois Power's electric customers will see no difference in the level or quality of service they receive, nor will the price they pay increase as a result of the transfer to WESCO.* The transfer of assets from Illinois Power to WESCO has been structured in a manner that enables Illinois Power to meet its service obligations in the same manner as it does today. We recognize that Illinois Power remains the entity required to meet the service obligations defined within the Act, as described in the Company's notice and in the testimony of Messrs. Reynolds and Eimer. *The transaction will be transparent to customers.* Illinois Power will remain the customers' regulated electric utility and, as described in detail in the Company's notice and in the testimony of Messrs. Reynolds and Eimer, will maintain all of its statutory service obligations and will continue to provide adequate, safe, and reliable electric service. *(portion in italics quoted by Mr. Lazare)*

At the time this testimony was submitted, on April 16, 1999, IP did not provide delivery services. In fact, the Commission approved the transfer of the fossil generating assets in an order dated July 8, 1999, and the transfer occurred on October 1, 1999, coincidentally the same date that the offering of delivery services to certain non-residential customers commenced. Later in his direct testimony in Docket No. 99-0209, Mr. Dreyer was asked to summarize, and his answer makes it clear that he was not talking about delivery services rates, which IP was not providing at the time, in the excerpt quoted by Mr. Lazare:

> Q. Please summarize your testimony.
>
> A. Illinova and Illinois Power must transition themselves in the face of restructuring and the changing marketplace. Transferring Illinois Power's non-nuclear generation to an affiliate is a transaction specifically contemplated by Section 16-111(g) of the Restructuring Law and is consistent with the objective to participate in competition. The PPA [power purchase agreement] between Illinois Power and WESCO will ensure that Illinois Power will continue to meet its obligation to provide adequate and reliable service to its tariffed service retail customers. Illinois Power's retail electric customers' base rates are frozen through the mandatory transition period ending December 31, 2004, and there is not a strong likelihood that the transfer would result in the Company being entitled to request a base rate increase under Section 16-111(d). Further, Illinois Power has eliminated its fuel adjustment clause. Therefore, Illinois Power's tariffed service retail customers are insulated from any price risk related to the transfer. Thus, the Commission should conclude that the transfer meets the standards of Section 16-111(g) of the Restructuring Law.

However, even if one were to construe the two sentences of Mr. Dreyer's testimony in Docket No. 99-0209 quoted by Mr. Lazare as a representation that delivery services rates (which had not yet been established at the time of the testimony) would not increase as a result of the transfer,

and even if one were to construe the level of G&I plant and A&G expense included in IP's proposed revenue requirement as producing an "increase", as Mr. Lazare apparently believes, that "increase" will occur more than three years after the date of Mr. Dreyer's quoted testimony.

22. Q. Did the Company transfer any G&I plant to Illinova as part of the transfer of the fossil generation facility?

A. Yes. G&I plant located at the power stations or otherwise directly associated with the fossil generation system was transferred to Illinova. The transferred G&I plant included buildings, office furniture and equipment; personal computers and other computing equipment; vehicles; tools, shop and garage equipment; laboratory equipment; power-operated equipment; communications equipment; and various computed software.

23. Q. Did the Company's filing in Docket No. 99-0209 include a listing of the G&I plant being transferred to Illinova, and a summary of the accounting entries associated with the transfer of the fossil generating assets from IP to Illinova?

A. Yes. The Company's 16-111(g) filing included a detailed listing of all assets, including the G&I plant, that was to be transferred. IP Exhibit 1.62 is a copy of the portion of the Company's 16-111(g) filing that listed the G&I plant being transferred. (The dollar values shown on this exhibit are the estimates used in the April 1999 filing, not the final values.) The Company also submitted the proposed accounting entries as part of its 16-111(g) filing. The Company submitted the final accounting entries associated with the transfer of plant after the transaction was completed. The Company's filing in Docket No. 99-0209 also included a certification from the Company's Chief Accounting Officer, as required by Section 16-111(g) of the Public

Utilities Act, stating that "the accounting entries related to the transfer of assets and liabilities from Illinois Power Company to Illinova, are in accordance with the guidelines for cost allocations specified in the Services and Facilities Agreement between Illinois Power and Illinova Corporation as approved by the Illinois Commerce Commission in Docket No. 94-0005."

24. Q. Did the sale of the Clinton Nuclear Station include the sale of any G&I plant to AmerGen?

A. Yes, those assets used in the ordinary course of business to operate the Clinton Nuclear Station were included as part of the sale. G&I assets such as machinery, both mobile and non-mobile, equipment (including computer hardware and software and communications equipment), vehicles, tools, spare parts, fixtures, furniture and furnishings and other personal property used in the ordinary course of business to operate the facility were included as part of the sale. The sale of the Clinton Nuclear Station specifically excluded G&I plant used only incidentally in the operation of the facilities, and assets and systems which were used to service multiple facilities.

25. Q. Would it make any sense to use the labor allocator to allocate a portion of IP's G&I plant to the generation function in this proceeding?

A. No. First, as I have noted, IP has had essentially no generation labor expense subsequent to December 31, 1999. However, putting that implementation issue aside, the more fundamental problem with allocating a portion of IP's G&I plant to generation would be that IP has owned essentially no generation subsequent to December 31, 1999, and its G&I plant is not used to support a generation business function. The labor allocator or other generic allocation formulas can be used to allocate plant that supports several of a company's lines of business among those

lines of business for costing and ratemaking purposes. However, there is no basis to allocate a portion of IP's G&I plant to business functions and assets that are now owned by separate legal entities.

26. Q. Is the increase in G&I plant allocated to electric distribution which Mr. Lazare (and IIEC witness Phillips) observe following the divestiture of IP's generation assets and business a function, at least in part, of the deficiencies of the labor allocation methodology?

A. Yes. Consider vehicles as an example. Illinois Power has a substantial investment in vehicles which are recorded in Account Nos. 392 and 396, Transportation Equipment and Power-Operated Equipment, which are General Plant accounts. Many of these vehicles are specialized vehicles such as bucket trucks, backhoes, and other service vehicles which are used only in the distribution business. Use of the labor allocator in the 1999 DST case resulted in a significant portion of the investment in these vehicles being allocated to the generation business, even though the generation function makes no use of these vehicles. With the generation business now divested, application of the labor allocator results in a much larger portion of the investment in vehicles being allocated to electric distribution. However, as I indicated above, vehicles assigned to and used at the power stations (such as equipment used in managing coal stockpiles) were transferred to IPMI and AmerGen as part of the sale of the generating stations.

27. Q. Please explain IP Exhibit 1.39.

A. IP Exhibit 1.39 summarizes activity related to IP's FERC Accounts that comprise the G&I classification (i.e., FERC Accounts 301 through 303 and 389 through 399), as well as production, transmission and distribution plant. The exhibit begins with total electric plant

balances at December 31, 1997 and sets forth the additions, retirements, transfers and adjustments for each plant classification through December 31, 2000, as reported in the Company's Form 1 to the Federal Energy Regulatory Commission ("FERC"). The most pertinent information on the exhibit can be found in Columns G and M. Column G reflects the impact of the impairment of the assets of the Clinton Nuclear Station, including related G&I plant, in 1998. In December 1998, IP recognized an impairment loss for Clinton, and wrote down the value of the plant from its then current book value to zero. In recognizing the impairment loss, approximately $43 million of G&I plant was written down to zero. This G&I plant was then included in the sale of assets to AmerGen in 1999. Column M reflects the transfer of the fossil generating assets from IP to Illinova in 1999, and shows that approximately $11 million of G&I plant was transferred with the fossil generating assets.

28. Q. How is this exhibit relevant to the level of G&I plant that should be included in IP's electric distribution rate base?

A. The amounts contained in Column S, Lines 1 through 17 of IP Exhibit 1.39 represent the actual level of G&I plant recorded on IP's books as of December 31, 2000. These assets are deployed in support of the management and operations of Illinois Power's gas, electric transmission and electric distribution businesses. Mr. Lazare seems to imply that a significant portion of IP's G&I plant supports a generation function. This is incorrect. The exhibit shows that $54 million of G&I plant that was previously on IP's books was sold or transferred to the buyers of IP's generating facilities. Those G&I assets on the books of Illinois Power as of December 31, 2000 are associated with, and applicable to, the discharging of IP's

responsibilities related to the operations of the gas, electric transmission and electric distribution businesses.

29. Q. Subsequent to the divestiture of its generating facilities, has the Company undertaken additional efforts to reduce its level of G&I plant?

A. Yes. The Company has attempted to consolidate facilities and eliminate unneeded assets. For instance, the Company has closed and sold a facility that was once used to house historical records. Those records are now maintained in the basement of the Company's headquarters building.

The Company has also reflected a pro forma adjustment in this proceeding to reflect the sale of an office building that previously housed the Decatur Public Library. This facility was purchased with the intent that it would house IP's fossil generation management personnel. Plans to use the facility changed with the divestiture of the fossil generation assets, and the Company subsequently made arrangements to sell that building.

The Company will continue to identify and eliminate any assets that are no longer required to support the provision of gas, electric transmission and electric distribution services.

30. Q. Does Mr. Lazare believe the Company should have done something differently with respect to G&I plant and A&G expenses, i.e., other than applying the labor allocator factors to its test year balances, in its filing in this case?

A. Apparently not, based on Mr. Lazare's response to IP's data request number 74. That data request and Mr. Lazare's response are as follows:

74. Explain how Mr. Lazare believes Illinois Power should have used a labor allocator to allocate G&I plant and A&G expense to "generation" in this case in light of the fact that IP had no "generation" labor in the year 2000.

Response: Mr. Lazare believes that when IP divested its generation, it should have reduced G&I Plant and A&G expense accounts that provide the foundation for delivery services ratemaking in a manner consistent with the Commission's Order in Docket No. 99-0134.

Thus, Mr. Lazare believes that IP did not transfer enough G&I plant or A&G expense to the buyers of its fossil and nuclear generation assets, or failed in some other manner simply to get rid of the portion of its G&I plant and A&G expenses that had been allocated to "generation" in the 1999 DST case. As I have indicated, IP transferred to the buyers of the generating stations the G&I plant that were directly related to the assets being purchased (e.g., located at the generating stations). Further, I am unaware of any complaints or concerns expressed by Staff or anyone else at the time of the transfers, or in the proceedings for Commission approval of the transfers, that IP was not transferring enough G&I plant (or A&G functions) to the buyers of the generating assets. However, the most fundamental problem with Mr. Lazare's position is that it assumes that IP could somehow sell to the buyers of its generating assets a portion of each of its bucket trucks, backhoes and other distribution service vehicles, a portion of a personal computer sitting on an accountant's desk and a portion of the desk itself, a portion of its headquarters building and of the IP Plaza Building in Decatur where IP's Call Center personnel are located – portions of all of these G&I plant items were allocated to "generation" by use of the labor allocator in the 1999 DST order. Mr. Lazare's position demonstrates a fundamental

lack of understanding of the types of equipment and expenses that make up common costs, and indeed of the very nature of common costs.

31. Q. Has the Company's overall level of G&I plant increased since 1997?

A. Yes, as IP Exhibit 1.39 shows, IP's total G&I plant increased by $14 million (3.7%) from 1997 to 2000. The Company has continued to make necessary and reasonable investments in G&I plant from December 31, 1997 through December 31, 2000, just as it continues to do so today. Individual capital additions to G&I plant between December 31, 1997 and December 31, 2000 in excess of $250,000 are identified and explained in IP Exhibits 1.32 and 1.33 and in Corrected Revised IP Exhibits 2.4 and 2.5. Additions to G&I plant to be placed in service between January 1, 2001 and June 30, 2002 are described in Corrected Revised IP Exhibits 1.5, 2.8 and 2.9 and in IP Exhibit 2.15. The net effect is that IP currently has a similar level of G&I plant as it had in 1997, but it is allocated over a smaller base of wages for IP's lines of business in this case. The end result is a larger allocation of G&I plant to the electric distribution business.

32. Q. Has Mr. Lazare identified any specific assets in IP's G&I plant accounts which he contends are unreasonable, unneeded to support the electric distribution business, or that should have been transferred with the generation assets?

A. No, he has not.

33. Q. How do you respond to Mr. Lazare's position that the increase of G&I plant should be limited to the increase in other distribution plant accounts?

A. Mr. Lazare's position ignores how the G&I assets are actually used, and would prohibit the

Company from recovering the costs of, and a return on those assets.

Further, adoption of Mr. Lazare's recommendation would result in a portion of IP's capital additions to G&I plant from January 2000 forward (i.e., subsequent to divestiture of the generation business) being allocated to something other than the gas, electric transmission and electric distribution businesses. Clearly, post-1999 additions were, and will continue to be, incurred solely in support of the gas, electric transmission and electric distribution businesses and not in support of a generation function. During the year 2000, the Company added approximately $9.7 million of electric utility G&I plant (net of retirements). Therefore, approximately $8.5 million, or 87.96 percent, of the year 2000 G&I plant additions would be applicable to the electric distribution business. As part of this filing, the Company has proposed to include an additional $12.7 million of G&I plant additions that will be placed in service after December 31, 2000. The entire $12.7 million of G&I plant additions are applicable to the electric distribution business. Under Mr. Lazare's proposed adjustment, these additions to G&I plant during the years 2000 and beyond are treated the same as G&I which he argues were used to support the generation function before the generating assets were divested. However, there can be no doubt that the G&I plant additions since January 1, 2000 were made solely in support of the Company's gas, electric transmission and electric distribution businesses. Thus, if the Commission were to adopt Mr. Lazare's methodology, the post-January 1, 2000 additions must be treated differently than the G&I plant on the Company's books as of December 31, 1999. As shown on IP Exhibit 1.40, allowing a proportional increase in G&I plant to the level of distribution plant as of December 31, 1999 compared to the level of distribution plant

allowed in the Company's last DST case, and allowing 100 percent of the additions to G&I plant since January 1, 2000, results in an increase in G&I plant of $31,648,000. In contrast, limiting all G&I plant additions since the 1999 DST case to the percentage increase in distribution plant between the 1999 DST case and the proposed level of distribution plant in this filing, as Mr. Lazare proposes, results in an increase in G&I plant of only $22,994,000. At a minimum, Mr. Lazare's proposed adjustment must reflect that 100 percent of the G&I plant additions since January 1, 2000 are used solely in support of the Company's gas, electric transmission and electric distribution businesses.

34. Q. Has Mr. Lazare correctly calculated the impacts of his proposed adjustment to rate base?

A. No, Mr. Lazare failed to reflect the impacts of his proposed adjustment on the level of accumulated deferred income taxes.

35. Q. Have you calculated the impact of Mr. Lazare's adjustment on the Reserve for Accumulated Deferred Income Taxes?

A. No, that calculation cannot be made based on Mr. Lazare's adjustment. Given that Mr. Lazare has not identified specific assets associated with his proposed disallowance, the impact of his adjustment on the Reserve for Accumulated Deferred Income Taxes cannot be accurately calculated. If Mr. Lazare identified specific assets that he believed were not used and useful in support of the Company's electric distribution business, the impact of such an adjustment could be calculated.

36. Q. Does IIEC witness Phillips also express concerns with regard to the amount of G&I plant in IP's proposed rate base?

A. Yes, Mr. Phillips argues that "IP has not presented valid reasons for the initial amount of net Intangible and General Plant ..." (IIEC Exhibit 3, p. 9, lines 6-9)

37. Q. What does Mr. Phillips recommend?

A. Mr. Phillips recommends that the net G&I plant only be increased in proportion to the increased amount of O&M expense required for delivery service. However, he does recognize that G&I plant additions may be included to the extent found appropriate by the Commission.

38. Q. How do you respond to Mr. Phillips position?

A. As with Mr. Lazare, Mr. Phillips fails to understand or reflect the differences in the structure of IP since the 1999 DST case. He too appears to be singularly focused on the result of the Company's analyses and faulting the process because of the answer. He fails to identify any specific G&I assets that are unreasonable, imprudent or not used and useful. His recommendation, like Mr. Lazare's should be rejected.

**B. Inclusion of Known and Measurable Capital Additions**

39. Q. Has CUB/AG witness Effron proposed an adjustment to limit IP's post-December 31, 2000 plant additions?

A. Yes, Mr. Effron has recommended that "post-test year additions should be limited to plant actually placed in service by six months after the end of the test year, or June 30, 2001." (CUB/AG Exhibit 2.0, p. 21, lines 18-20).

40. Q. Has Mr. Effron identified specific proposed capital additions that he believes are unreasonable, unnecessary or unlikely to be made by the Company?

A. No, Mr. Effron appears to simply disallow any additions beyond June 30, 2001.

41. Q. Is such a limitation reasonable?

A. No, the Commission has historically allowed companies to include pro forma adjustments for post test-year additions such as IP is proposing in this case. As Staff witness Hathhorn testifies, a typical rule of thumb has been to allow additions or increased expenses which are reasonably certain to occur within twelve months following the filing of the tariffs, which would be May 30, 2002 in this case. This is consistent with the proposition that operating expenses and plant investment should be representative of those costs incurred by the utility during the first twelve months that the rates are in effect.

42. Q. Is there reasonable certainty that the plant additions for which the Company has proposed a pro forma adjustment will occur within 12 months from the filing date of the Company's tariffs?

A. Yes, the Company has provided significant information to substantiate that the capital additions will be made, both in filed testimony and in response to data requests. I have addressed the non-Energy Delivery capital additions (G&I plant items) while IP witness Barud has addressed the Energy Delivery capital additions (distribution additions and certain G&I plant additions).

## C. Accumulated Depreciation Associated with Embedded Plant in Service Through June 30, 2001

43. Q. Please describe CUB/AG witness Effron's proposed adjustment to accumulated depreciation.

A. Mr. Effron proposes that growth in the accumulated depreciation reserve for plant in service as of the end of the test year, December 31, 2000, should be recognized for six months after the end of the test year, i.e., through June 30, 2001 (CUB/AG Exhibit 2.0, page 24). Illinois Power will accept this adjustment with respect to the accumulated reserve for depreciation

associated with plant in service as of December 31, 2000, and will also make a corresponding adjustment to Accumulated Deferred Income Taxes. The Company's adjustments for post-test year additions already take into account accumulated depreciation on those additions, as well as related retirements of plant that is replaced by the additions.

44. Q. What is the impact of including the additional accumulated reserve for depreciation?

A. Including an additional six months of accumulated reserve for depreciation increases the reserve for depreciation by $15,945,000, $2,492,000 and $2,830,000 for distribution, general, and intangible plant, respectively, for a total rate base reduction of $21,266,000, as shown on IP Exhibit. 1.41. The corresponding adjustment to Accumulated Deferred Income Taxes increases the reserve for deferred taxes, and therefore reduces rate base, by $10,639,000 as shown on the same exhibit.

**D. The appropriate lead/lag associated with two items within the Company's cash working capital analysis**

45. Q. Please describe Mr. Effron's proposed adjustment pertaining to Cash Working Capital.

A. Mr. Effron proposes modifications to the lags assigned to Injuries and Damages and to the Invested Capital/Electric Distribution Tax.

46. Q. What is the effect of Mr. Effron's proposed modifications?

A. Mr. Effron states that the effect of his proposed modifications is to reduce calculated cash working capital by $7,437,000 resulting in an adjusted cash working capital allowance amount of $2,696,000.

47. Q. How does Mr. Effron propose to modify the lag associated with Injuries and Damages?

A. By focusing on the claims aspect of insurance coverage for injuries and damages alone, Mr. Effron states that a zero lag is appropriate.

48. Q. Do you agree with Mr. Effron's analysis?

A. No, while it is correct that a zero lag is appropriate on claims, Mr. Effron does not consider the lag effect associated with premium payments made by the Company associated with policies purchased to provide excess injury and damage coverage. These premiums, which are pre-paid at the beginning of a year, have a lag of 182.5 days.

49. Q. What is the effect of considering these premium payments on cash working capital?

A. The effect of considering these premiums and their attendant half-year lag is a positive cash working capital amount of $520,279.

50. Q. How is this amount calculated?

A. The total Company amount associated with these excess coverage policies is $1,628,000. Consistent with how the Company functionalized its expenses, a labor allocator percentage of 57.9 percent was used to derive the amount ascribable to the electric distribution business, resulting in an allocated amount of $942,000. An amount of $98,000 was added to the allocated premiums to reflect known increases in 2001 liability premiums resulting in a total premium amount (including pro-forma adjustments) of $1,040,558. A lag of 182.5 days was applied to this total resulting in a cash working capital requirement of $520,279.

51. Q. How does Mr. Effron propose to modify the lag associated with the Invested Capital/Electric Distribution Tax?

A. Based on his assumption that "all the required payments are made on the designated date for the estimated payments within the year" (CUB/AG Exhibit 2.0, p. 27, lines 2-3), Mr. Effron states that a negative lag of at least 29.75 days should be used when computing the cash working capital requirement associated with the Invested Capital/Electric Distribution Tax. Mr. Effron then calculates a negative cash working capital requirement of $2,124,000 using his estimate of negative lag.

52. Q. Do you agree with Mr. Effron?

A. No, Mr. Effron makes the assumption that all required payments are made on the designated date for each quarter's estimated tax liability.

As shown on IP Exhibit 1.42, the Company issued checks on March 8th, June 2nd, August 28th, and November 27th of 2000 for payments that were due on March 15th, June 15th, September 15th, and December 15th for the quarters ending March 31st, June 30th, September 30th, and December 31st of 2000 respectively. Additionally, the Company issued a check on March 8th, 2001 for the remaining balance due on account of the Invested Capital/Electric Distribution Tax. With the exception of the final true-up payment, which only has a lead associated with it, each payment had both a post-paid lead day amount and a pre-paid lag day amount adjusted for bank float of approximately 2.45 days based on check clearing data. The mid-point of these lead and lag days, weighted by the dollar amounts that were paid, results in a lead time of 25.0253 days.

53. Q. What is the cash working capital impact of this lead time on invested capital/electric distribution tax?

A. This lead time reduces cash working capital by $1,812,000 rather than the reduction of $2,124,000 suggested by Mr. Effron.

54. Q. Have you made other revisions to the cash working capital analysis to incorporate the impacts of other revisions and adjustments to rate base, expenses and return that affect the cash working capital requirements?

A. Yes. As shown on IP Exhibit 1.37, the revised cash working capital requirement, incorporating all the changes (including those resulting from Mr. Effron's proposals) is $3,026,000.

**E. Capitalization of severance costs**

55. Q. Please explain ICC Staff witness Hathhorn's proposed treatment of capitalized severance costs.

A. Ms. Hathhorn proposes to disallow all severance costs as merger transactional costs. I will discuss the appropriateness of allowing the Company's severance expense later in my testimony. Ms. Hathhorn also recommends, however, that the Company should not capitalize any portion of severance expenses.

56. Q. How do you respond to Ms. Hathhorn's proposal?

A. Ms. Hathhorn's proposal is contrary to the normal accounting for such "A&G" expenses. Prior to leaving the Company, many of the individuals who received severance payments and benefits recorded their time to FERC Account 920, Administrative and General Salaries. Prevailing accounting theory is that such A&G activities typically are performed in support of both the day-to-day management of the Company (i.e., expensed) as well as to manage the construction and addition of assets of the Company (i.e., capitalized). It is standard utility accounting practice to capitalize a portion of the administrative costs that are incurred in support of the

construction and addition of assets. Therefore, a portion of the annual salaries of those individuals that are no longer with the Company would have been routinely capitalized. Given that the severance costs were incurred to eliminate certain positions that were no longer required, the Company believes that it is appropriate to record the severance expense in the same manner that the expense that is being eliminated would have been recorded. Therefore, the Company believes that it is appropriate to capitalize a portion of severance expense.

57. Q. Has Ms. Hathhorn accurately calculated the amount of her proposed adjustment related to the capitalization of severance costs?

A. No, she has not. Ms. Hathhorn calculates the portion of her proposed plant in service adjustment associated with depreciation expense and accumulated depreciation based on certain ratios that she calculates. In fact, the adjustments should employ a 2.34 percent distribution depreciation rate for the severance costs capitalized to distribution assets and other depreciation rates for severance costs capitalized to G&I assets. Using Ms. Hathhorn's method, the capitalized severance costs would be fully depreciated in less than three years. Ms. Hathhorn employs a similar methodology for her adjustment to deferred taxes. The result is that Ms. Hathhorn's calculated adjustment overstates the true impact of the intended adjustment.

## F. Exclusion of certain deferred income taxes from rate base

58. Q. Does CUB/AG witness Effron propose the elimination of certain deferred tax balances from the determination of rate base?

A. Yes, Mr. Effron proposes to eliminate "certain deferred tax debit balances that are related to reserves, deferred credits, or accrued liabilities that are not recognized in the calculation of rate

base." (CUB/AG Exhibit 2.0, p. 28, lines 1 – 3).

59. Q. Do you agree with Mr. Effron's recommendation?

A. No, Mr. Effron's proposal results in an inconsistent treatment of accumulated deferred income taxes. Accumulated deferred income taxes serve as a reduction to the determination of rate base. The balance of the accumulated deferred income taxes is made up of a number of debit balances, which reduce the overall reduction of rate base, and credits, which increase the reduction to rate base. Mr. Effron only excludes certain deferred tax debit balances associated with items that are typically not considered in the determination of rate base. There are also deferred tax credit balances associated with items not considered in the determination of rate base. Therefore, Mr. Effron has selectively applied his recommendation to reduce rate base. His proposed adjustment is incomplete. If the Commission were to determine that those deferred tax balances associated with items that are not considered in the determination of rate base should be excluded, both the debit and credit balances should be excluded.

60. Q. Please explain how deferred taxes are created and the proper regulatory treatment for those deferred taxes.

A. Deferred taxes arise from timing differences between when the Company recognizes income and expenses for book and tax purposes. For example, assets are typically depreciated over shorter time periods for tax purposes than for financial/regulatory purposes. Under tax laws and normalization rules, the tax benefit of accelerated depreciation allowed the utility is not reflected in rates as incurred, but is instead deferred and reflected in rates only as book (regulatory) depreciation exceeds tax depreciation. The result is that tax expense is reflected in rates in the

year that it is recorded for financial book (regulatory) purposes. However, the difference between the tax expense for financial purposes (based on book depreciation) and actual tax payments to the government (based on accelerated depreciation) reduces the Company's rate base for cost of service purposes. In effect, the revenues provided for tax expense in excess of actual tax payments represent non-investor-supplied capital. Thus, rate base is reduced by deferred taxes and customers' rates are lower by the effect of the allowed rate of return on the deferred taxes.

Mr. Effron raised a similar issue in a previous IP bundled electric rate case, Docket No. 89-0276. In that docket, Mr. Effron challenged IP's inclusion in rate base of the remaining balance of deferred taxes associated with unbilled revenues. The final order in that proceeding stated:

> The Commission concludes that since this deferred tax is like any deferred tax, arising out of a timing difference between the book treatment and tax treatment of the same expense or income item, it should be treated like other deferred taxes for ratemaking purposes and be reflected in the calculation of IP's rate base. (Commission Order in Docket No. 89-0276, pp. 94-95)

## G. Accumulated Depreciation and Accumulated Deferred Income Taxes related to Plant Additions

61. Q. Does the Company accept Staff witness Everson's proposed adjustment to limit proposed capital additions to only funded projects?

A. As discussed by IP witness Barud, the Company has accepted Ms. Everson's adjustment to limit proposed capital additions to those projects that have been approved and funded.

62. Q. Does Staff witness Everson's proposed adjustment to reduce the Company's level of capital

additions accurately reflect the impacts of her proposed adjustment?

A. No, as I discussed with regards to Staff witness Hathhorn's proposed adjustment to rate base to eliminate the capitalization of severance costs, Ms. Everson employs certain ratios to calculate the impact of her adjustment to depreciation expense, accumulated depreciation and accumulated deferred income taxes. The Company has accepted Ms. Everson's adjustment to plant additions but on IP Exhibits 1.36, 1.38 and 1.43 has correctly calculated the related depreciation expense, accumulated depreciation and accumulated deferred taxes.

## IV. Operating Expenses

63. Q. Are there any adjustments to operating expenses that have been proposed by Staff witnesses that the Company accepts?

A. Yes, there a number of proposed adjustments to operating expenses to which the Company does not object.

64. Q. Please identify the specific adjustments and the witness proposing each one.

A. The Company accepts the following proposed adjustments:

* Staff witness Hathhorn's adjustment to the Gross Revenue Conversion Factor incorporating a rate for Uncollectibles;
* Staff witness Hathhorn's adjustment to eliminate certain reimbursements to Clinton Power Station employees;
* Staff witness Hathhorn's adjustment to remove the portion of 2000 incentive compensation that was added to base salaries in calculating the adjustment for increased wage and salary rates in 2001;

* Staff witness Hathhorn's adjustment to correct inter-company billings based on the proper allocation factors under the Services and Facilities Agreement;
* Staff witness Pearce's adjustment to exclude the portion of EEI dues applicable to Lobbying expenses; and
* Staff witness Pearce's adjustment to eliminate the Energy Efficiency tax expense.

65. Q. In light of the fact that the Company opposes Staff witness Hathhorn's adjustment to disallow incentive compensation expense, why are you accepting her adjustment to remove incentive compensation payments from the base of 2000 wage and salary expense that was used to calculate the Company's adjustments for wage and salary increases in 2001?

A. As IP witness Hearn testifies, one of the advantages of an incentive compensation program is that incentive compensation payments awarded to employees in one year are not locked into their base compensation in the same way as annual wage and salary increases. The Company's original presentation of the adjustment for 2001 wage and salary increases, in IP Exhibit 1.26, in effect assumed, incorrectly, that the anticipated wage and salary increases to Company employees in 2001 over 2000 would apply to the incentive compensation payments they received in 2000.

66. Q. Are any of your previously filed exhibits pertaining to operating expenses superceded due to changes that you are making in this rebuttal filing?

B. Yes, the following exhibits reflect changes to my previously filed exhibits:

* Exhibit 1.43 (supersedes Corrected Revised IP Exhibit 1.22) presents the increase in depreciation expense associated with the revised level of pro forma plant additions presented in IP's rebuttal case; and
* Exhibit 1.44 (supersedes Corrected Revised IP Exhibit 1.26) presents a corrected level of O&M expense increases for 2001 due to wage and salary expenses; this exhibit now eliminates 2000 incentive compensation payments from the base to which the 2001 wage and salary increases were applied.

67. Q. What issues will you address related to operating expenses in your rebuttal testimony?

A. I will address the following issues in my rebuttal testimony:

A. 1999 Rulemaking Expenses
B. Y2K Amortization Expenses
C. Severance Costs
D. Incentive Compensation
E. Contributions for Community Organizations
F. Functionalization of A&G Expenses and Charges from Dynegy
G. Injuries and Damages Expense
H. Litigation Expenses
I. Amortization Expense for Intangible Plant

## A. 1999 Rulemaking Expenses

68. Q. Has Staff witness Hathhorn proposed a modification to the Company's pro forma adjustments related to two separate Commission rulemakings?

A. Yes, Ms. Hathhorn disallows certain expenses related to the Company's participation in Commission rulemakings related to Standards of Conduct/Functional Separation and Affiliate Transactions. Ms. Hathhorn disallows the expenditures because she considers them to be "out of period costs from the test year." (ICC Staff Exhibit 1.0, p. 7, line 153).

69. Q. Please explain the nature of the Company's pro forma adjustment related to these two rulemakings.

A. These two pro forma adjustments consist of two parts. The first part of the adjustment includes in the test year the unamortized expense associated with these rulemakings that was allowed by the Commission in the 1999 DST case. Ms. Hathhorn agreed with this portion of the Company's pro forma adjustment. The second part of the adjustment is to add to the unamortized amount additional costs that the Company incurred beyond those allowed in the 1999 DST case.

70. Q. Can you provide a brief history related to the costs associated with these rulemakings?

A. Subsequent to the passage of the Electric Service Customer Choice and Rate Relief Law of 1997, the Commission initiated a number of rulemakings, and other proceedings related to the restructuring of the electric industry, that were required by the new statute. IP was an active participant in those proceedings and incurred incremental expenses associated with such participation. In the 1999 DST case, the Company proposed pro forma adjustments to amortize the costs of participating in these rulemakings over a three-year period. The costs to be amortized included costs that had already been incurred associated with the two rulemakings as well as anticipated expenses for the remainder of the proceedings. The Commission Staff proposed, and the Commission adopted, a reduced level of anticipated expenses, on the grounds that not all the costs proposed by IP for inclusion in the adjustment met the "known and measurable" standard applied in the DST proceeding. Staff proposed, and the Commission accepted, an amortization of the resulting amounts over a five-year period.

71. Q. Were the expenses for these rulemakings that the Commission, in the 1999 DST case, allowed to be amortized and recovered over a five-year period, incurred during the test year for that case?

A. No. To the contrary, none of the expenses for these rulemakings that the Commission allowed to be recovered in the 1999 DST case were test year expenses. The test year in that case was the twelve months ended December 31, 1997 and the expenses allowed to be recovered were incurred in 1998 and 1999.

72. Q. What additional cost is the Company attempting to recover in this proceeding?

A. In the 1999 DST case, the Commission concurred that the Company should be allowed to recover its costs of participating in these two rulemakings. Certain expenses not yet incurred for these rulemakings were excluded from recovery because they did not meet the "known and measurable" standard. The additional expenses added to the unamortized balance in this proceeding represent the additional actual costs incurred by the Company associated with those rulemakings. The Company's pro forma adjustment simply provides for recovery of the costs associated with the rulemakings that were not allowed in the 1999 DST case because they did not yet meet the "known and measurable" standard.

73. Q. Ms. Hathhorn argues that the inclusion of these additional expenses associated with IP's participation in the rulemakings creates a mismatch between current period operating expenses with current period revenues. (ICC Staff Ex. 1.0, p. 8, lines 162-163). Do you agree?

A. I do not agree with Ms. Hathhorn's position. The expenditures in question are non-recurring costs that the Company was required to incur associated with regulatory proceedings. The

Company should have the right to amortize and recover these expenses.

In support of her argument, Ms. Hathhorn states:

> The Company's current adjustment relates to unique costs from pro forma adjustments in its prior DST case. The Company did not analyze if all the other expenses and pro formas from that case actually were incurred at the level approved in its revenue requirement. Those costs may have been higher or lower; it is most certain the exact amount approved was not the Company's actual experience. This scenario is inherent to the regulated ratemaking process. (ICC Staff Ex. 1.0, pp. 8-9, lines 173-179)

Ms. Hathhorn's position mischaracterizes the purpose and objective of the Company's pro forma adjustment. Ms. Hathhorn implies that the Company is seeking some form of retroactive ratemaking adjustment to recover expenses that were under-budgeted or unanticipated at the time of the last DST proceeding. To the contrary, the Company anticipated these expenditures in the 1999 DST case. The expenditures were disallowed because they did not yet meet the interpretation of the "known and measurable" standard that was employed in that case. The Company's pro forma adjustments in this case simply identify and seek amortization and recovery of the additional actual expenditures of a specific type and purpose that the Commission, in the 1999 DST case, deemed it was appropriate to allow.

## B. Y2K Amortization Expenses

74. Q. Please describe Ms. Hathhorn's adjustment related to Year 2000 ("Y2K") expenses.

A. Ms. Hathhorn's proposed adjustment consists of two parts. The first is the functionalization of the Y2K expense. The second part of her adjustment disallows 1999 Y2K expenses as out of period costs.

75. Q. Does the Company concur with Ms. Hathhorn's functionalization of the Y2K expense?